

Committee on Resources

Testimony

Subcommittee on Water and Power

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**STATEMENT OF RANDALL W. HARDY
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BEFORE THE
SUBCOMMITTEE ON WATER AND POWER
OF THE HOUSE COMMITTEE ON RESOURCES
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INTRODUCTION**

Chairman Doolittle and members of the Subcommittee on Water and Power of the House Committee on Resources (Subcommittee), I am Randy Hardy, Administrator of the Bonneville Power Administration (Bonneville). I appreciate this opportunity to discuss the future of Bonneville in the competitive electric utility marketplace.

Bonneville, as is true with all players in the electric utility industry, is facing unprecedented challenges and change. I commend this Subcommittee for its continued focus on the public and economic impacts of a new, more competitive electric utility industry. The Subcommittee's attention and support are essential as we work together to address these challenges.

My testimony today will focus on several topics. First, I will provide a brief background on the goals of the Comprehensive Review of the Northwest Energy System (Comprehensive Review) and Bonneville's role in the Comprehensive Review. I will then comment on the recommendations made by the Comprehensive Review. My testimony will then focus on the actions our agency is planning or has already started to implement, along with a discussion of issues that we believe may require assistance from the Congress. My testimony will address all of the topics covered in your invitation including the subscription process, separation of Bonneville's transmission and marketing functions, and our ability to participate in a regional independent grid operation (IGO).

COMPREHENSIVE REVIEW AND BONNEVILLE'S ROLE

In the wake of the emergence of competition in the wholesale electricity market, and in response from a request from the Department of Energy (DOE), in January, 1996, the Governors of Oregon, Washington, Idaho, and Montana initiated a public process to recommend changes in the institutional structure of the Northwest's electric utility industry. Throughout 1996, the Comprehensive Review, composed of leaders in business, industry, utilities, government, and the environment, worked to foster agreement on the best regional approach to address the transition from regulation to competition.

From the start, Bonneville actively participated as an information resource in the Comprehensive Review and firmly endorsed the Governors' consensus building process. In December 1996, the Comprehensive Review delivered its recommendations. From our perspective, the recommendations accomplish four important objectives: (1) creating the opportunity to retain the benefits of the Northwest Federal hydrosystem for Northwest consumers, (2) fostering the use of the Federal transmission system to help

achieve a competitive power market for the benefit of all consumers, (3) improving the likelihood that taxpayers and bondholders will have their investment repaid, and (4) creating a funding mechanism for preserving important public benefits.

Specifically, the Comprehensive Review's final report included the following recommendations among others:

- legally separate Bonneville into power marketing and transmission agencies;
- create a Federal Energy Regulatory Commission (FERC) regulated IGO that includes Bonneville;
- sell Federal power by subscription at cost-based rates in 5 to 20 year increments;
- continue public and regional preference for Federal power;
- frees Bonneville to sell its power at market prices to the extent regional entities do not in the future purchase power on a long-term basis or buy option fees;
- allocate to United States Treasury (Treasury) some share of benefits when Bonneville power is below market;
- invest approximately \$210 million annually (roughly equivalent to three percent of regional utility revenues) in public benefits;
- allow state and local governments to determine how public benefit funds will be collected;
- allow retail customers to choose their own electricity supplier by July 1999;
- leave implementation of customer choice at retail level to the states; and
- request that governors initiate discussions to resolve river governance issues.

PERSPECTIVES ON THE REGIONAL REVIEW

On January 4, 1996, Deputy Secretary Charles B. Curtis sent a letter to the Comprehensive Review team as a part of the kickoff of the study. The letter outlined the two key concerns of the Administration with respect to recommendations for the future of Bonneville and the Northwest electric power system:

First, regardless of the ultimate structure that is adopted for the federal power system, it is essential that this system continue to serve important public purposes such as providing reliable and affordable power to Northwest homes and businesses, funding fish and wildlife recovery efforts, and supporting energy efficiency and renewable technologies . . . Second, it is critical that the costs and liabilities associated with the Bonneville system, including the Washington Public Power Supply System and Federal Treasury debt, continue to be borne by the beneficiaries of the Bonneville system.

The Administration continues to believe these principles are valid.

In general, the Administration is favorably inclined toward the Comprehensive Review recommendations. However, we are not prepared to adopt a final Administration position of the Comprehensive Review's recommendations for a number of reasons, including the fact that the Administration is presently in the midst of interagency discussions to determine our overall position on the electricity restructuring issue. Nevertheless, we do have perspectives on some of the key issues the Review considered that could be of some assistance to the Congress and the Northwest region as we grapple with these difficult issues.

The Administration believes a credible effort has been made by the region to address the Administration's principle that the costs and liabilities associated with the Bonneville system continue to be borne by the beneficiaries of the system. However, the Administration is disappointed that the Comprehensive Review was unable to make more progress on addressing the potential for a cost recovery mechanism for Bonneville. If the Northwest is going to seek to retain the benefits of the system, and if Bonneville's statutes are to be changed to provide more open transmission access, the position of Treasury and bondholders must be protected by assuring cost recovery. The Administration supports statutory changes which create a more robust contingent stranded cost recovery mechanism for Bonneville.

The Administration wants healthy salmon and a financially healthy Bonneville. The Administration believes the 1996 Fish Memorandum of Agreement (MOA), and Administration mechanisms for sharing fish costs, created a balance between these objectives. The Administration believes that a successor to the MOA, which is based on sound science and Bonneville's ability to attract customers and cover its costs, is a worthy goal and is willing to work with the region to this end.

Recognizing that the Comprehensive Review did not include fisheries issues as part of its charter, the Administration is interested in proposals that would improve river governance.

BONNEVILLE'S POST-COMPREHENSIVE REVIEW ACTIONS

In December 1996, upon release of the Comprehensive Review's final report, Bonneville and other regional parties immediately began to explore the actions necessary to implement the Comprehensive Review recommendations. To monitor, guide, and evaluate progress of the recommendations, in early 1997, the Governors' Representatives formed a Transition Board. Bonneville is working closely with the Transition Board, customers, and other regional parties to refine--not change or reinvent--the Comprehensive Review's results. If there are unforeseen barriers to implementing the Comprehensive Review's recommendations, Bonneville will bring such issues to the Transition Board's attention.

Bonneville's actions are being guided by the three broad goals included in the final report. These goals, as outlined in the power marketing section of the report, include:

- aligning the benefits and risks of access to existing Federal power;
- ensuring repayment of the debt to the Treasury with a greater probability than currently exists without compromising the security or tax-exempt status of the Bonneville's third-party debt; and,
- retaining the long-term benefits of the system for the region, while being consistent with emerging competitive markets and regional transmission solutions.

Subscription Process

The principle of a subscription process is among Bonneville's top priorities. The Comprehensive Review recommended that Bonneville offer Federal power by subscription at cost-based rates in 5 to 20 year increments. We expect to continue work on the details of this concept in the future.

In early spring, Bonneville and the Pacific Northwest Utilities Conference Committee (PNUCC) invited 2,800 interested parties throughout the region including customers, industries, interest groups, and others, to help lay the groundwork for the subscription process. A collaborative process to design a subscription system began with a public kickoff meeting held on March 11, 1997. Approximately 75 people, representing Bonneville, existing and potential customers, and other regional parties, attended. At the kickoff meeting, the Bonneville/customer design team presented its proposed work plan. An important element of the work plan was the formation of a Subscription Work Group (Work Group), under the auspices of the PNUCC, to work through the issues necessary for implementation of the subscription recommendations of the Comprehensive Review. The Work Group, which is open to the public, will meet twice a month for most of 1997. Five Work Group meetings have been held to date, with 30 to 40 participants at each.

The Work Group has made excellent progress. It has completed a sharing of customer and Bonneville business interests and is now in the midst of discussing the types of products and pricing principles that would satisfy those interests. Contractual frameworks are being developed. Progress has been so good that the group is actively discussing expediting the schedule, so that this collaborative phase can produce final contract principles by the summer of 1998. At that time, bilateral contract negotiations between Bonneville and individual customers could begin. So far, the Work Group has found no reason to modify its working premise that the subscription recommendations can be implemented without changes in Federal law.

While Bonneville hopes to implement the subscription process administratively, there are a number of areas

in the Comprehensive Review's recommendations that could require legislation. This assumption will be tested as the process moves along. The Work Group, through the Transition Board, expects to report back to Congress within six months on the need for legislation.

The subscription process provides two potential benefits for taxpayers and bondholders which do not currently exist. First, if Northwest customers choose not to purchase the cost-based product under the subscription process, or pay an option fee, they must pay a market based rate for any future power purchases. Second, subscribers will pay a premium for power purchases when Bonneville costs fall below market rates. These provisions are calculated to assure repayment to the Treasury and create opportunities for repayment of additional Federal debt, and improve the security of the non-Federal debt.

Separation Legislation

The Comprehensive Review also called for the legal separation of Bonneville into transmission and power entities. This will involve legislation.

Bonneville has already achieved administrative separation of its power and transmission businesses, and is acting so as not to compromise future legal separation. It is presently unclear how legislation will define separation. There are a variety of different forms or governance structures which could be utilized for the power and transmission business lines. Until such time as Bonneville is legally separated, the agency will continue as a single Federal entity under one Administrator.

Separation raises numerous substantive issues that must be resolved. The fundamental questions that must be addressed concern Bonneville's public purpose and cost recovery obligations relative to the goal of providing open transmission access as outlined in the Energy Policy Act of 1992 (Energy Policy Act). The Energy Policy Act addressed all these issues by having these objectives apply to Bonneville and leaving to administrative processes the appropriate balancing. With conflicts between these objectives increasing, it is appropriate to reconsider this conclusion.

Independent Grid Operator

The Comprehensive Review also recommended creation of a FERC regulated IGO that includes Bonneville. Bonneville has participated in discussions on formation of a regional IGO called IndeGO. This issue is further examined in the section on Implementation Needs.

Recent Cost Reductions

To meet the market, over the past three years Bonneville has taken significant actions to reshape the agency. After extensive cost cutting, reorganization, and downsizing, Bonneville initiated a 13 percent rate reduction that will be effective through fiscal year (FY) 2001. Major actions included new power sales contracts with preference customers and ten direct service industries (DSI); stabilizing our fish and wildlife budget through 2001; allowing Bonneville to sell excess Federal power outside the region for up to seven years; and phasing out the Residential Exchange.

Cost cutting and downsizing made an enormous contribution to rate reduction and maintaining a competitive position. Three major cost cutting efforts since 1995 have reduced our projected expenditures by an average of \$600 million annually relative to the FY 1995 Congressional Budget. We have also met our target of reducing Federal and contractor staff levels by more than 1000 positions.

While our initial cost cutting targets have been met, we are now working on further reductions in order to continue to meet the market.

Power Business Line Cost Reductions

The projected average annual expenses the Power Business Line (PBL) must recover through its power rates during the 5-year rate period 1997-2001 were reduced significantly in several rounds of cost-cutting that began in 1994.

About two-thirds of the \$600 million occurred on the power side, in long-term power acquisitions, reinvention of the conservation program, phase-down of the Residential Exchange Program, and overhead expenses. All of these cost reductions were reflected in the Revenue Requirement for the 1996 Rate Case. Since the Rate Case was completed, PBL has continued to cut its costs. For FY 1997, PBL's expenses currently are projected to be approximately \$20 million less than projected in the Rate Case.

In order to succeed in the post-2001 period, Bonneville intends to manage its costs so that it can compete in power markets that value energy at 2 cents per kilowatt-hour. This will require further reductions in PBL's annual expenses, from the 1996 Rate Case 5-year average of about \$1.76 billion. Given that there are very difficult trade-offs involved in meeting such a goal, Bonneville intends to work with the Northwest Power Planning Council to establish a mechanism, similar to the Sounding Board which we used in 1995, as a means to publicly involve customers, and interest groups regarding Bonneville costs and strategic positioning in the post-2001 period.

Transmission Business Line Cost Reductions

During 1996 Final Rate Case negotiations, transmission capital and expense costs were cut by about \$63 million annually on average from 1996 Supplemental Proposal levels, heavily impacting transmission system development, system maintenance, and replacements. Reductions in transmission capital investments came from numerous projects and represented a mix of changes in approach. These included accomplishing some planned projects through cost sharing with other utilities, reducing the scope or delaying projects, and eliminating transmission system additions in favor of less costly system controls.

At the beginning of FY 1997, the Transmission Business Line (TBL) took an additional \$15 million cut in operating expenses for the year. The TBL set aggressive goals for reducing costs and at eight months into the FY is still on-target. On the capital side, TBL started the year with an additional \$11 million cut. Concurrently, the TBL has been able to absorb \$22 million in unplanned system reliability projects resulting from last summer's system outages, as well as nearly \$4 million in emergency replacement projects due to winter storm damage. To assist in this reduction effort, a Matrix Team was established to develop capital prioritization criteria and evaluate capital projects. The team currently ensures that the TBL manages within capital borrowing constraints and intends to continue doing so.

All transmission expense and capital programs are designed to allow Bonneville to keep transmission rates flat for 10 years. TBL capital obligation reductions have been significant. These reductions have made enduring impacts by reducing fixed costs in the form of depreciation and interest expense, as well as extending limited borrowing authority.

These and future actions will help to ensure that the Northwest receives maximum economic and environmental benefits from the Columbia River, and by meeting our Treasury obligation, the taxpayers are guaranteed a return on their investment.

IMPLEMENTATION

The following is a discussion of the issues Bonneville is currently reviewing.

Separation of Bonneville's Power and Transmission Businesses

The Comprehensive Review recommended that Bonneville's power marketing and transmission functions be separated to enhance the operation of the region's electricity marketplace. Bonneville supports the Comprehensive Review's recommendation. However, the Comprehensive Review did not specify what form separation should take or, once separated, how the two functions should be regulated. Legislation would be required if Bonneville's power and transmission functions were to be separated into two distinct agencies. There are other options short of legal separation, which the Transition Board and Congress may choose to explore. Bonneville is working with the Transition Board to help the region identify the issues raised by

legal separation of the agency's power and transmission functions and to present a reasonable range of options for what forms and governance different Federal separation scenarios could take.

There are many issues that must be resolved if Bonneville's power marketing and transmission functions are to be separated legally, including:

- Bonneville is a single agency of the DOE headed by a single Administrator. If it is split in two, there must be an allocation of assets and responsibilities under law, including treaties and contracts. Which form(s) should Bonneville and its power and transmission businesses take?
- The Bonneville Administrator currently is appointed by the Secretary of Energy and reports to the Deputy Secretary of Energy. Who should have the authority to appoint the officers of the resulting organizations and what should be the reporting requirements?
- The Office of Management and Budget, DOE, Congress, and the FERC now exercise oversight of Bonneville; Bonneville is advised by the Northwest Power Planning Council. How should oversight and advisory functions be structured for the separated power and transmission businesses?
- Bonneville's rates currently are reviewed by FERC under unique statutory standards. FERC may order Bonneville to provide transmission services consistent with Bonneville's statutes. Like other publicly-owned and Federal utilities, however, Bonneville is exempt from most of the Federal Power Act (Power Act) and FERC regulations. Bonneville, nonetheless, chose to comply with the provisions related to open and comparable transmission access. How should the Power Act and FERC regulations apply to the transmission function?
- Bonneville's financial obligations are currently managed through a single fund, even though the power and transmission functions are accounted for separately within this fund. All Bonneville purposes are general obligations of the single Bonneville fund. If the transmission and power businesses are legislatively separated, what should become of the single Bonneville fund and what security will there be for meeting Treasury payments?
- The bonds for the Washington Public Power Supply System (WPPSS) nuclear plants are backed by a Bonneville pledge to use its full capability to raise revenues, not just by the power business' capability. How should the security of these payments be ensured?
- WPPSS debt is secured by tax-exempt bonds, which have received Internal Revenue Service (IRS) rulings allowing tax-exempt treatment. If the underlying bases for the IRS rulings is changed, all or a portion of the bonds could become taxable back to their original date of issuance. What should be done to ensure that does not happen?
- Agreement on how Bonneville will meet its Canadian Treaty obligations as the U.S. Entity, including Entitlement return, back up and operational requirements;
- In providing power, transmission and other services, including public responsibilities, costs are incurred. How should these costs be allocated?
- The Energy Policy Act requires FERC to give first priority on constrained Federal transmission pathways to transactions that serve Northwest loads. Should the priority to Northwest loads continue?
- Federal power has priority access to constrained Federal transmission when the Administrator determines such a priority is necessary or appropriate to meet Bonneville's financial and fish obligations. Should the priority access of Federal power to transmission services continue?
- Under the Energy Policy Act, all transmission providers may refuse transmission service requests if such service would replace energy which the provider has a right to deliver under contract. If Bonneville transmission and Bonneville power marketing are separated legally, should the Bonneville transmission entity continue to provide this protection or Bonneville's power marketing entity or should it terminate?
- The Federal transmission system has a priority access to any Federal generation resources needed to maintain system reliability. This includes generation for load regulation, operating reserves, voltage support, generator dropping for remedial action schemes, and the ability to quickly adjust Federal generation when reliability is threatened. Moreover, Bonneville has arrangements with Federally served loads whereby Bonneville has the right to interrupt these loads for reliability reasons. Should the priority access of Federal transmission to Federal power and loads continue?

- Bonneville's separation impacts Bonneville's participation in an IGO. The IGO issues are identified in another part of this testimony.
- Bonneville has many public responsibilities. These include marketing power at cost; public and regional preference; conservation and renewable resources development; fish and wildlife mitigation; safety and reliability standards; low-density discounts and postage-stamp rates for rural consumers; compliance with the Endangered Species Act; compliance with National Environmental Policy Act (NEPA) environmental standards; public decisionmaking; one-utility planning -- a long-term regional perspective; regional and international hydro-coordination; partnership with the four Northwest states; tribal trust relationships; and repayment of the Federal taxpayers' investment. The potential effects of separation on public responsibilities in a deregulated energy market need to be explored.

Independent Grid Operator Issues

The Comprehensive Review recommended the formation of an IGO regulated by the FERC with broad membership, including Bonneville and the region's other major transmission owners. Bonneville supports the recommendations of the Comprehensive Review, and agrees that a properly structured IGO can ensure independence of transmission operations, improve efficiency and enhance reliability. However, Bonneville believes participation in an IGO would likely require legislation.

While some parties have concluded that it is appropriate for Bonneville to join IndeGO, a proposed IGO that covers Northwest and Rocky Mountain states, many publicly owned utility and DSI customers have expressed concerns. Bonneville participation in IndeGO is also a major policy decision that must be widely supported by the region. Further, the views of interest groups and the Congress are not known. Bonneville has committed significant resources to help establish IndeGO, and will continue to support the effort. Bonneville "participation" in the September IndeGO filing to FERC would include revenue and contract information. Following a determination of adequate legal authority and a decision for Bonneville to participate in IndeGO, Bonneville would initiate a rate case under the procedures in Section 7(i) of the Northwest Power Planning and Conservation Act. The minimum time required is about 90 days.

Bonneville should not be asked to express a greater level of commitment to IndeGO than other signatories to the Memorandum of Understanding. All other signatories have stated that their commitment to IndeGO is subject to FERC approval of the final documents without changes or new conditions. Thus, Bonneville advance commitments would be inappropriate. In addition, key issues, such as rate design, have not been decided. No party is committed to the filing until these issues are resolved.

Bonneville believes there are a number of procedural and substantive issues that would need to be resolved before Bonneville could commit to participate in IndeGO. For example:

- congressional authorization for participation will likely be necessary because of conflicts with Bonneville's transmission responsibilities under its existing authorities (for example, the obligation to operate the Federal transmission system);
- assurance of Bonneville cost recovery, including (1) the right to include power-related and public purpose costs in the Bonneville transmission revenue requirement charged to IndeGO if the PBL is unable to recover them, (2) a mechanism to assure cost recovery where appropriate, and (3) overall sufficiency of cashflows to ensure timely repayment of the Federal investment in transmission;
- assurance that IndeGO transmission services will not facilitate the breach of existing Bonneville power contracts through either wholesale or retail wheeling or the current Bonneville rate settlement;
- assurance that if Bonneville joins IndeGO, IndeGO, to the extent necessary, will assume Bonneville's obligation to provide transmission services under the Energy Policy Act;
- a determination by bond counsel that transfer of control of the transmission facilities to an IGO and limitations on costs that Bonneville may recover through transmission rates charged to an IGO do not constitute an impairment of the WPPSS bonds;
- agreement on how the transmission system will be used to respond to fish emergencies;

- agreement on how Bonneville will meet its Canadian Treaty obligations as the U.S. Entity, including Entitlement return, back up and operational requirements;
- completion of Bonneville's NEPA responsibilities, which may be accomplished by an amendment to Bonneville's Business Plan Environmental Impact Statement to address Bonneville's IndeGO participation (an amendment would take several months);
- agreement on Northwest and Federal load priorities; and
- address any United States Constitution separation of powers question that may arise if an IGO is interposed between the President and the Bonneville transmission function.

The issues listed above require public debate and resolution. The debate needs to include the Administration, Congress, Treasury, WPPSS, public interest groups, publicly owned utilities, DSIs and investor owned utilities. Rifleshoot legislation that narrowly authorizes Bonneville participation would defer resolution of many public policy issues to a contract negotiation process.

Since IndeGO will not start scheduling until 1999, there should be sufficient time to find administrative or legislative solutions for these issues.

Cost Recovery Issues

The Comprehensive Review recognized that in order to retain the benefits of the FCRPS for the Northwest, the Northwest must commit to absorbing the costs. The Comprehensive Review recognized that cost recovery for Bonneville is appropriate, although it did not specify the mechanism to be used for cost recovery. Bonneville believes that under most market conditions, if Bonneville's costs, including fish recovery costs, remain stable, there will be minimal likelihood, if any, that costs will be "stranded" or unable to be recovered. But, if alternative power prices remain low, or costs, including fish recovery costs, rise substantially, there is the potential need for a cost recovery mechanism if Bonneville is to avoid shifting risk to the United States taxpayer. Market price risk is a different type of risk than has historically been absorbed by taxpayers which was based on the natural variability in Bonneville net revenues, primarily due to streamflow conditions.

Bonneville's public responsibilities and its financial obligations to bondholders and the Treasury require that the agency focus on cost recovery as opposed to the more narrow issue of "stranded costs." Simply put, Bonneville's current obligation is to assure that all of its rates--both power and transmission--produce sufficient revenues to assure total, overall cost recovery. While the power and transmission functions should and, we believe, will ordinarily pay their own way over time, the revenue generating capability of one function may be relied upon to cover the costs of the other function if necessary. Under the FERC's "stranded investment" recovery rules, transmitting utilities that are unable to recover generation costs from power customers have essentially a one-time, limited opportunity to recover stranded investment from departing customers determined by (1) calculating annual average expected customer revenues based on the last three years of revenue from the customer prior to the customer's departure as a consequence of open transmission access, (2) subtracting mitigation from that amount of expected customer revenues, and (3) multiplying the difference times the length of the period that the utility had a reasonable expectation of serving the departing customer.

As mentioned, Bonneville's present authority to cover a power-side underrecovery is to levy a surcharge on its current transmission customers' use of the Bonneville transmission system. While we believe such authority should be sustained against legal challenge, there are legal risks present and it is clear that our customers would aggressively pursue a challenge. Many parties believe such a charge is inequitable because it focuses cost recovery for power business underrecoveries on users of the transmission system. Consequently, Bonneville needs and the Administration supports a contingent stranded cost recovery mechanism, to help avoid burdening the United States taxpayers, who under law stand last in the line of Bonneville creditors. The mechanism must be fair and must not ease pressure for containment of costs.

System Benefits Charge

To ensure that cost-effective conservation, renewable resource development and low income weatherization are sustained during the transition to competition and beyond, the Comprehensive Review recommended that by July 1, 1997, and annually thereafter for a period of 10 years, three percent of the revenues from all electrical utilities' electricity sales in the region be dedicated to those purposes.

The Comprehensive Review recommended that by July 1, 1999, each of the Northwest states enact legislation that ensures that all electric utilities operating within its borders are meeting the minimum standard for investment in development of conservation and renewable resources and provision of weatherization and energy efficiency services to low income consumers. The Comprehensive Review recommended that utilities should demonstrate compliance with the minimum standard also by July 1, 1999.

If this minimum standard is not being met, the Comprehensive Review recommends that state legislation should provide for the assessment of a uniform system benefits charge that ensures the collection and investment of funds for these purposes. The Comprehensive Review strongly recommended prompt legislative action simultaneous with open retail access.

Neither Bonneville nor other wholesale suppliers of electric power can continue to incur the costs of these activities. Competition forces most of such costs out of the power wholesaler's system. A system benefits charge must operate so as not to interfere with power supply competition.

Salmon Recovery Costs

The Administration and Congress have helped immensely by stabilizing and providing some certainty to Bonneville's contribution to Northwest fish and wildlife restoration and mitigation. Through an agreement with the Administration, Bonneville has stabilized fish and wildlife costs through FY 2001. The period beyond 2001, however, is a major issue before us.

Under the Endangered Species Act (ESA) and the Northwest Power Act, Bonneville has been given responsibility for providing much of the funding for the protection and restoration of fish and wildlife -- and particularly salmon runs -- in the Columbia River Basin. We are committed to healthy salmon based on sound science. The challenge for the years beyond 2001 is to fulfill this responsibility while offering customers the cost certainty and rate levels that are required in today's highly competitive power markets.

For 60 years, residents of the Pacific Northwest have paid cost-based rates for electric power from the FCRPS. The power was sold under long-term contracts to utilities and DSIs in the region, and what was surplus to the region's need was sold short-term outside the region, principally to California utilities. Bonneville's current 20-year supply contracts with its regional customers expire in 2001. Between now and then, Bonneville will be asking whether and to what extent this kind of relationship should continue. The advantage to Bonneville of this kind of relationship -- load commitment for at-cost power -- is revenue stability and a high assurance of adequate cost coverage. The advantage to Bonneville customers is a long-term relationship to a power supply that ought to be below-market over the long run.

The single largest obstacle to customers entering into an at-cost (subscription) relationship with Bonneville is our customers' perception of exposure to greater costs for fish recovery under the ESA, or other programs. These costs were increasing until the recent MOA was reached with the Administration for the period until 2001. For subscription to be successful these costs must again be made predictable for at least the period of the shortest subscription products -- 5 years, beginning in 2001. We expect to sell subscription products as premium products, with customers paying to have a renewal option or right. Given current market price forecasts, we may be somewhat above market when subscription is offered, so the premium can only be sustained if customers value the longer-term potential of at-cost power from the FCRPS. In order to address this problem of cost predictability, the Administration will engage in discussions to develop a successor to the MOA among the Federal agencies charged with salmon recovery responsibilities under ESA.

There exists a reciprocal relationship between the subscription process and the success of Bonneville's

funding requirements for its fish and wildlife program. While the latter is key to the former, as I have just mentioned, in order for Bonneville to succeed on both fronts, the subscription process must succeed in order to assure adequate revenue to fund fish and wildlife efforts.

CONCLUSION

Mr. Chairman, we commend the Northwest governors and the Comprehensive Review for assuming a most challenging task with a very tight timeline. The Comprehensive Review delivered a workable framework for the Northwest which Bonneville supports.

The Administration supports a structure that will continue to serve the important public purposes Bonneville has historically provided, including reliable and affordable power to Northwest homes and businesses, funding fish and wildlife recovery efforts, and supporting energy efficiency and renewable technologies. The Administration's position also reflects that the costs and liabilities associated with the Bonneville system, including both the WPPSS and Treasury debt, continue to be borne by the beneficiaries of the Bonneville system.

Operationally, we are making significant changes to reshape our agency and meet the market. Cost cutting and downsizing have made an enormous contribution to rate reductions and maintaining a competitive position. Our agency's financial condition is strengthening, even given intense competitive pressures. We have set ambitious and measurable targets for all of our functions, and are making significant progress towards meeting each of these targets. The actions we have taken will help to assure that we provide competitive rates and protect the investment of the Federal taxpayer.

Over the next year, on a policy level, Bonneville will be focusing on four specific areas -- subscription, separation, cost recovery, and a post-2001 fish budget agreement.

Subscription -- we will need a successful power sales process in conjunction with continued cost management to maintain a commercially successful business with stable revenues.

Separation -- Bonneville is working to identify issues associated with splitting its generation and transmission businesses. Separation will need to speak to fundamental questions about how historical public benefits will be provided.

Cost Recovery: -- Cost recovery, or so-called "stranded costs", have captured growing national attention raising public policy and equity issues for all electric utilities. The Comprehensive Review recommendations assume a system where the Northwest has the opportunity to retain the benefits of the system. It is the Administration's view that, under such a system, it is reasonable to expect the Northwest to absorb the costs. We expect to work with the Transition Board to develop a mechanism which is fair, sustainable, and financially sound.

Fish and Wildlife Mitigation -- Bonneville's responsibilities remain uncertain after 2001 when the current fish agreement ends. The Administration wants healthy salmon and believes that a successor to the 1996 fish MOA, which is based on sound science and Bonneville's ability to attract customers and recover its costs, is a worthy goal and needed in order to give the subscription process a chance to work.

I want to again commend this Subcommittee for its continued focus on the public and economic impacts of a new, more competitive electric utility industry. The issues brought before you today, coupled with national restructuring legislation and continued pressure to reduce our agency's costs, will make the next five years critical for Bonneville. Decisions about Bonneville power and transmission will impact the Northwest economy, funding for environmental protection, and repayment of the Federal and non-Federal investment. The Subcommittee's attention and support are essential as we work together to address these challenges.

This concludes my formal statement. I would be pleased to address any questions you may have.

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